**COMMONWEALTH OF MASSACHUSETTS**
**before the**
**DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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| **Western Massachusetts Electric Company** | ) | **D.T.E. 05-10 / 04-109 / 04-40** |

# INITIAL BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,


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## I. INTRODUCTION

As required by G. L. c. 164, §§ 1-2 ("the Restructuring Act"), Western Massachusetts Electric Company ("WMECo" or "Company") filed an Electric Restructuring Plan ("Plan") with the Department of Telecommunications and Energy ("Department") on December 31, 1997. The Plan, docketed as D.T.E. 97-120, offered the Company's retail customers competitive electric generation service and requested recovery of transition costs related to the Company's investment in nuclear, fossil fuel and hydroelectric generating units. In the reconciliation filings now under consideration, WMECo proposes: (1) an unfair accounting of its refinanced prior spent nuclear fuel ("PSNF") obligation; (2) a treatment of systems, consulting, and litigation costs, and under-recovered Standard Offer Service ("SOS") and Default Service ("DS") balances that conflict with applicable tariffs; (3) a calculation of carrying charges that does not provide for the "maximum possible mitigation," as required by the Restructuring Act; and (4) a transition charge rate design that creates subsidies and that the Company should eliminate.

## II. PROCEDURAL HISTORY

On March 31, 2005, pursuant to G. L. c. 164, § 1A(a), and 220 C.M.R. § 11.03(4), the Company submitted an amended reconciliation filing for calendar years 2003 and 2004 in an attempt to reflect the Department's directives in its reconciliation order in *Western Massachusetts Electric Company*, D.T.E. 01-36/02-20 (2003) and the rate settlement in *Western Massachusetts Electric Company*, D.T.E. 04-106 (2004). The Company submitted the testimony of Robert A. Baumann and Michael J. Mahoney in support of its filing. The Attorney General intervened in the proceeding as of right, issued discovery and submitted the testimony of David J. Effron in support of adjustments to the Company's proposal. On September 13, 2005, the Department conducted one day of hearings.

## III. STANDARD OF REVIEW

The Restructuring Act sets forth the standard of review that the Department must employ in this proceeding. It requires the Department to "identify and determine . . . those costs and categories of costs for generation-related assets, investments, and obligations . . . which may be allowed to be recovered through a non-bypassable transition charge. . .." G.L. c. 164, §1G(a)(1). The Department reviews the filings to "ensure that the proposed reconciliations are consistent with or substantially comply with the Restructuring Act, the Company's approved restructuring plan, applicable law, and Department precedent." *Boston Edison Company*, D.T.E. 98-111, p. 4 (1999) (reconciliation settlement approval under the Restructuring Act). Nothing in the Restructuring Act can be construed as relieving the Company of its duty to prove, by substantial evidence, compliance with these requirements. "Transition costs" are determined by the Department only after "accounting for maximum possible mitigation." G. L. c. 164, § 1.

## IV. ARGUMENT

### A. Prior Spent Nuclear Fuel Credit

At the end of the third quarter of 2004, WMECO refinanced its PSNF obligation, pursuant to authorization granted by the Department in D.T.E. 03-82. In that proceeding the Company had filed for approval to issue long-term debt securities. The Department ordered the issuance of debt pursuant to G. L. c. 164, §§ 14 and 17A, after determining the Company met the "net plant" and "reasonably necessary business purposes" tests. *Western Massachusetts Electric Company*, D.T.E. 03-82, p. 22 (2004). Now, the Company argues that the Department's approval under G. L. c. 164, §§ 14 and 17A, for the issuance of debt automatically substitutes for the Department's approval of transition charges under the "maximum mitigation" test in the Restructuring Act and other relevant analysis. G. L. c. 164, § 1;*Boston Edison Company*, D.T.E. 98-111, p. 4 (1999) (review of filings to ensure compliance with the Restructuring Act, the approved restructuring plan, and other applicable law); Exh. AG-1-6; AG-2-2 (discussing WMECO's position). The Company's position is contrary to law and the Department should not adopt it.

#### 1) The Company May Not Substitute Approval Under One Statute For Approval Under Another.

The Supreme Judicial Court has already rejected a utility's attempt to have the Department substitute the test under one statute for its duty to apply a different standard under another statute. *Cambridge Electric Co. v. Department Public Utilities*, 333 Mass. 536, 538-39 (1956) (addressing the price of stock issued under G. L. c. 164, §18, with an assessment of reasonable rates G. L. c. 164, §94). In that case, the Cambridge Electric Company requested that the Department set rates sufficiently high under G. L. c. 164, §94, to maintain the price of stock issued years earlier by the utility. *Id*. The Department had originally approved the issue price under the "public interest" standard of G. L. c. 164, §18, but that price had since fallen. *Id*. In the decision, the Court addressed the different obligations of the Department when setting rates under G. L. c. 164, §94, and when conducting a "public interest" analysis:

> ***One duty*** is that defined in c. 164, §18, the so-called premium law, to prevent the issue of stock at a price 'so low as to be inconsistent with the public interest.' ***The other duty*** is to fix rates to be paid by the public under [G. L. c. 164] section 94. The performance of these two duties is not governed by the same considerations.

*Id* (emphasis added). The Court, tracing different statutory provisions to different underlying considerations, notes that the standards are so different that "[i]t seems plain that the two kinds of inquiry which the department may be called upon to make do not follow parallel lines and will not necessarily produce nicely dovetailed results." *Id*. The Court also cautioned that the Department may not conduct one inquiry in such a way as to "disable itself from later performing the other according to law." *Id*. The Department simply may not undercut its duty under one provision (setting rates) through action under another (fixing the price of stock).

In this reconciliation proceeding under the Restructuring Act, WMECO asks the Department to approve automatically its proposed 50/50 sharing mechanism of the savings from the PSNF refinancing since the Department already approved the refinancing itself under G. L. c. 164, §§ 14 and 17A. But the refinancing involved the "net plant" and "reasonably necessary business purposes" tests, not the "maximum mitigation" test under the Restructuring Act. G. L. c. 164, §§ 1G(b)(1); 1G(c)(1)(iii) and 1G(d)(1); *Boston Edison Company*, D.T.E. 98-111, p. 4.

### 2) The Company's Sharing Mechanism Is Unfair And The Department Should Order Maximum Mitigation For Customers.

The Company's proposal fails the maximum mitigation test because it does not pass along sufficient savings to customers from its recent refinancing, and, in fact, raises transition rates. The Company calculated the change in the transition charge reconciliation ("TC") net operating income requirement from the elimination of PSNF accrual and then subtracted from that the net of tax interest expense on the debt issued to refinance the PSNF obligation. The Company then split the difference 50/50 between customers and investors and grossed up that amount for taxes to arrive at a revenue requirement basis. Exh. AG 1-6. The customer share of the annual PSNF credit was calculated to be $2,228,000. As the refinancing took place ¾ of the way into 2004, the Company reflected ¼ of the annual PSNF, or $557,000, in the 2004 TC reconciliation.

The Company's proposal to divide the increase in operating income between ratepayers and investors is inequitable and unreasonable. It is undisputed that the Company's refinancing of the PSNF imposed additional costs on ratepayers. Mr. Effron described the additional costs as a result of the PSNF refinancing and the inadequacy of the Company's proposed sharing mechanism to mitigate the increased costs being borne by customers:

> Prior to the refinancing, the accrued PSNF liability was treated as a reduction to the fixed cost base on which the return included in the fixed cost component of the TC was calculated. Prior to the refinancing, the PSNF obligation in 2004 was approximately $48 million. At the 2004 rate of return of 13.11% (again, prior to the refinancing), this reduction to the fixed cost base reduced the return included in the fixed cost component of the TC by $6.3 million. Interest accrued on the PSNF obligation of approximately $0.5 million is included in the variable component of the TC. Thus, the net effect had been a reduction to the TC revenue requirement of $5.8 million. Therefore, refinancing the PSNF obligation had the effect of increasing the TC revenue requirement by approximately $5.8 million annually, exclusive of the effect of the inclusion of the new debt in the capital structure, which increases the TC revenue requirement even more. This compares to the customer share of the annual PSNF credit of $2.2 million

> calculated by the Company. The PSNF credit included in the TC reconciliation by WMECO does not come close to making customers whole for the additional costs imposed by the PSNF refinancing.

Exh. AG-1/DJE, p. 6. In response to cross-examination by the Department, the Company agreed that the refinancing was costly to customers. Transcript ("Tr."), pp.42-46.

In these circumstances, the sharing mechanism proposed by the Company is wholly inadequate to mitigate the additional costs imposed on customers. Indeed, even if 100% of the increased income were credited to ratepayers, it would still not make them whole for the increased costs resulting from the refinancing of the PSNF liability. The Company's reflection of the effect of its proposed 50/50 sharing is based entirely on its contention that the Department "authorized" the proposed sharing mechanism in D.T.E. 03-82. Exh. AG-1-6; AG-2-2. A careful reading of the Department's order in D.T.E 03-82 makes clear that, although the Department acknowledged the details of the Company's proposal, the Department did not specifically approve or authorize the requested sharing mechanism, nor did it engage in the legal analysis required by the Restructuring Act to do so.

WMECO cites three sections of the order in D.T.E 03-82 that it claims ordered the proposed sharing mechanism:

> In the Department's July 19, 2004 Order, the Department describes WMECO's sharing proposal as follows: "WMECO states that because the ultimate benefit of the financing would not be realized by customers until the Company's next rate case, it [WMECO] proposes to share the increase in net income with customers until that time, with 50 percent passed back to ratepayers through the annual transition charge reconciliation (Exh. WM-2, at 5; Tr. at 64)....The Company proposes to implement the sharing mechanism only until the next rate case..." (Order, p. 4).
>
> In its Order, the Department found that "The Company has demonstrated that the creation of the Trust will decrease WMECO's average cost of capital and benefit

> ratepayers both in the short-term through the proposed sharing mechanism and in the long-term through a lower weighted cost of capital" (Order, page 17).
>
> The Department proceeded formally to order into effect WMECO's financing proposal, including the sharing mechanism (Order, page 22).

Exh. AG-2-2. With regard to the first passage, WMECO's characterization is correct. The Department did describe the sharing proposal on page 4 of the order. It is contained in the section of the order headed "DESCRIPTION OF COMPANY PROPOSAL." However, this passage is just that – a description and no more. This narrative statement cannot be construed to be an approval of the sharing proposal or authorization by the Department to implement it.

In the second cited passage, the Department makes reference to benefits to ratepayers in the short term through the proposed sharing mechanism in the context of its analysis under the "reasonably necessary business purposes" test of Section 17A. It did not engage in a mitigation analysis or any other analysis under the Restructuring Act. [1]

The statement by WMECO that "The Department proceeded formally to order into effect WMECO's financing proposal, including the sharing mechanism" is unsupported by the text of the decision. The ordering clauses authorize the issuance of securities to establish the trust for refinancing, but are silent on the proposed sharing mechanism and do not reference the Restructuring Act in any way. *Western Massachusetts Electric Company*, D.T.E. 03-82, p. 22. The Department did authorize the Company to issue securities, but did not authorize any specific sharing of the increase to income resulting from the elimination of the PSNF liability.

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[1] In D.T.E. 03-82, the Department dismissed the Attorney General's arguments under the Restructuring Act as "not relevant" and "misplaced" in a proceeding simply to approve the issuance of debt. *Western Massachusetts Electric Company*, D.T.E. 03-82, p. 15. These arguments, however, are appropriately made in this reconciliation proceeding.

Even if the full amount of the WMECO increase in operating income, approximately $4.4 million annually on a revenue requirements basis, were credited to customers, it would still not compensate them for the $5.8 million increase in the TC revenue requirement caused by the refinancing of the PSNF. Allocating only one-half of the difference to customers as proposed by the Company -- $2.2 million on an annual basis -- only exacerbates the increased costs imposed on customers by the Company. In order for the Company to comply with the Restructuring Act, at a minimum, and treat customers fairly, WMECO should credit customers with the full amount of the net increase in operating income.

## B. Systems, Consulting, and Litigation Costs

The Company seeks to collect inappropriate costs through the reconciliation mechanisms in its transition filing. WMECO's tariffs specifically describe reconcilable standard offer service ("SOS") costs:

> The Company shall reconcile the revenues billed to customers taking Standard Offer Service against payments to Suppliers of Standard Offer Service . . ..

The tariff for default service ("DS") costs is similarly specific:

> On an annual basis, the Company shall reconcile its total cost of purchased power for Default Service against its total Default Service revenue . . ..

In the current proposed reconciliation, WMECO has included expenses identified as generation information systems costs, RFP consulting costs, and litigation costs in the reconciliation of SOS and DS revenues and expenses. Mr. Effron described what these payments represent:

> The generation information systems costs are administrative expenses related to the verification of retail electric suppliers' compliance with green power and environmental regulations. These costs are billed by ISO-NE to responsible market participants such as WMECO (response to AG1-018).

> RFP consulting costs are expenses associated with an independent consultant to verify the impartiality of the processes used in the development of requests for proposal to provide standard offer service and default service. The independent consultant was retained pursuant to the order of the Department in D.T.E. 97-120 (response to AG1-018).
>
> The litigation costs are for outside counsel related to legal disputes arising between WMECO and power suppliers in the procurement of SOS and DS. Such disputes have led to litigation and arbitration regarding the terms of the supply contracts, resulting in the litigation costs incurred by WMECO (response to AG1-023).

Exh. AG-1/DJE, p. 9. These costs might be necessary, reasonable, or prudent but they certainly are not "payments to Suppliers of Standard Offer Service" or the "cost of purchased power for Default Service." Company witness Baumann eventually acknowledged this fact on cross examination. Tr., pp. 18-21. Whatever these costs may be, they are not the actual costs of standard offer service and default service. Rather, they are the general and administrative costs incurred by WMECO as the incumbent distribution utility responsible for providing SOS and DS to its customers. These costs, then, are properly treated as being a component of the distribution administrative and general expense and should not be included in the reconcilable SOS and DS costs. The Department should order the elimination of the generation information systems costs, RFP consulting costs, and litigation costs from the reconciliation, resulting in the reduction of the reconcilable SOS costs for the years 2002-2005 by $1,017,000 and the reduction in the reconcilable DS costs for the years 2002-2004 by $285,000. Exh. AG-1/DJE, p. 9.

### C. Under-Recovered SOS and DS Balances

Although the Department has never approved shifting recovery of SOS and DS reconciliations to the TC reconciliation, the Company has included the 2001 DS under-recovered balance of $2,924,000 (including interest) in the variable component of the 2003 TC reconciliation. The Company has also included a charge of $5,389,000 to the variable component of the 2004 TC reconciliation, representing the net balance of the 2003 SOS under-collection, the 2002 DS over-collection, and the 2003 DS under-collection, all with interest. Exh. WMECO-1 / MJM-3, Page 3).

As established on cross examination by the Department, the Company's proposal raises the issue of the appropriateness of the return that WMECO will earn on the under-recovered SOS and DS balances:

> BY MR. PASSAGGIO:
> Q. Enough on that. Let's go to -- the company proposes to recover unrecovered standard-offer- service and default-service unrecovered balances through the transition charge in this proceeding; is that correct?
> A. [MAHONEY] Yes, we have asked for that.
> Q. Under the prior method of recovery did the company pay interest on -- pay customers interest on overcollection or receive interest from customers on undercollections?
> A. [MAHONEY] Yes.
> Q. And can you tell me at what interest rate? And just to facilitate things, I happen to be looking at Exhibit RAB-1, Page 1, and RAB-7, Page 17 of 38
> A. [MAHONEY] I have those.
> Q. Could we say that in 2003 that the interest would be 2.64 percent?
> A. [MAHONEY] That would be the interest rate on customer deposits, that was used in this calculation.
> Q. Just subject to check, if you looked at the corresponding figure for 2002, would you agree that it was 3.83 percent?
> A. [MAHONEY] Yes.
> Q. Now, if the Department approves the company's proposal, transition charges approved in this case will increase, will they not? Let me be more specific. Let me back up a bit. The company has an overrecovery of its transition costs; is that correct?
> A. [MAHONEY] That is correct.
> Q. And the company pays carrying charges on that overrecovery to customers; is that correct?
> A. [MAHONEY] Yes, it does.
> Q. And they pay these carrying charges at the pretax weighted cost of capital; is that correct?
> A. [MAHONEY] That is correct.
> Q. This situation is very analogous to the prior spent nuclear fuel credit, in my

> view, because is it fair to say that what would happen here is that you would be taking overrecovery on which carrying charges are being paid at the pretax weighted cost of capital and reduce that by the net underrecovery of standard-offer service and default service? Is that correct?
> A. [MAHONEY] Yes.
> Q. In effect, sir, would you not be earning interest at the pretax weighted cost of capital?
> A. [MAHONEY] On that net balance, we would.
> Q. On the net balance. The last question: Can you tell me what the pretax weighted cost of capital is for the most recent year?
> A. [MAHONEY] I believe I can.
> Q. I think, subject to check, that it's 12.84 percent.
> A. [MAHONEY] That's in the ballpark.

Tr., pp. 46-49. Mr. Mahoney provided no reason why the Department should shift the recovery of SOS and DS reconciliations to the TC reconciliation. In fact, the Company's own SOS tariff specifies that under-recoveries remaining at the end of the standard service period "shall be recovered from all Retail Delivery Service customers by a uniform surcharge not exceeding $0.005 per kilowatt-hour commencing after such period." The DS tariff specifies that any excess or deficiency resulting from the reconciliation of DS revenues and expenses "shall be refunded to, or collected from, all Distribution Company customers on a per kilowatt-hour basis over the following 12 months, with interest, through a Default Service Cost Adjustment Factor." Neither of these tariffs provide for recovery of under-collected SOS and DS balances through the TC reconciliation. Accordingly, the Department should reject the Company's proposal to include SOS and DS under-recovered balances from prior years in the TC reconciliation. Rather, these under-recovered balances should be recovered by the means specified in the applicable tariffs.

### D. Calculation of Carrying Charges

The Company's calculation of carrying charges requires a slight adjustment. WMECO calculates carrying charges on the over/under-recovered balance of transition charges by applying its pre-tax cost of capital to the balance net of income taxes. As Mr. Effron explained in his direct testimony:

> In general, the Company's method of calculating carrying charges appears to be appropriate. However in calculating the net-of tax balance to which the carrying charge rate is applied, WMECO used a net of tax factor of 60% instead of the actual net of tax factor of 60.775%. That is, with a state income tax rate of 6.5% and a federal income tax rate of 35%, the combined tax rate is 39.225%, and the complement of this combined tax rate is 60.775%. This is the appropriate rate to use to calculate the net of tax balance to which the carrying cost rate should be applied. On my Schedule DJE-1, I have calculated that using a net of tax factor of 60.775% rather than the 60% used by the Company increases the carrying charges accrued on the net over-recoveries by $102,000 as of the end of 2004.

Exh. AG-1/DJE, pp. 4-5. On cross examination, WMECO witness Mahoney agreed that the combined tax rate is 39.775%, not 40%. Tr., p. 11. There appears to no dispute that, in calculating the net-of tax balance to which the carrying charge rate is applied, the actual net of tax factor of 60.775% is appropriate.

At the request of the Company, Mr. Effron re-calculated his adjustment to the carrying charges accrued on the net over-recoveries to reflect the 1999 fuel charge credit as of September 30, 1999, rather than as of the mid-point of 1999. This recalculation resulted in an adjustment to the carrying charges of $96,000 rather than the $102,000 Mr. Effron originally calculated. Exh. WM-1-5; Tr., pp. 54-55. The Attorney General agrees that this modification is appropriate. Accordingly, the carrying charges accrued on the net over-recoveries should be increased by $96,000 as of the end of 2004, to reflect the application of the appropriate net-of-tax factor of 60.775% in the calculation of the net-of tax balance to which the carrying charge rate is applied.

### E. Transition Charge Subsidies

The Company's transition charge rate design creates subsidies that should be eliminated.[2] As shown in Exhibit AG-2 residential customers are paying more than other classes on a cents per kilowatt hour basis.[3] In 2003 the average residential transition charge revenue was $0.0153 per kWh and the average for all customer classes was $0.0141 per kWh. In 2004 the residential average was $0.00916; the average for all customers was $0.00836. These data indicate that the residential customers in the rate classes R-1, R-2, R-3 and R-4 are paying more than the average of other rate classes.[4] The revenues from all rate classes are pooled and credited to the Company's total transition costs. Each year the Company determines a new uniform transition

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[2] The Department requires electric distribution companies to collect non-bypassable transition charges from customers based on a uniform cents per kilowatt transition charge. Due to rate design constraints related to the original unbundling of rates and the mandatory requirement that all standard service customers receive initial discounts of 10 per cent and later 15 per cent, certain customer classes' transition charges are not collected through the imposition of the uniform rate. However, the rates are designed to produce the same class level of transition charge revenue as if the uniform rate were in effect. *Cambridge and Commonwealth*, D.P.U./D.T.E. 97-111, pp.41-42 (1999) and *Fitchburg* DTE 97-115/98-120, pp. 41-42 (1999).

[3] "Customer class" means a general grouping of customers in the categories Residential, Small C&I, Street Lighting, Large C&I and Special Contracts and "rate classes"refer to groups of customers served under the same tariffs (R-1, R-2, R-3, G-1, T-1, etc.).

[4] When asked about the data and the conclusions that could be drawn from the data contained in Exhibit AG-2, the Company's witness could not explain why there were rate class subsidies in the Company's transition charge. Tr. pp. 27-28. His only comment was that the revenues included demand charges without explaining why it was inappropriate to include all transition charge revenue when analyzing deviation from the uniform transition charge on a rate class basis, especially given that some of the Company's rate classes have transition costs collected through demand charges. *Id*. The Company used the same kWh data in its response to RR-AG-3, which itself asked for an explanation what was wrong with the calculations presented in Exhibit AG-2. The Company provided in RR-AG-3 a calculation of transition charge revenue per kWh based on class revenues that are inconsistent with those provided in the Company's response to AG 2-19 (2003 and 2004 monthly transition charge revenue by class). The response to AG 2-9, along with the response to AG 2-20 (2003 and 2004 monthly kWh sales by class), formed the basis for the calculations contained in Exhibit AG-2. In both the record request response and during hearings, the Company failed to explain why the revenue levels are different and why the use of kWh are appropriate.

charge that applies to all classes. If a rate class provides less than, or more than, the revenue that would have been generated under the application of the uniform rate, this results in subsidies. Several electric companies, the NSTAR companies and the Massachusetts Electric Company, have recognized this inequity and reconcile their transition charges on a rate class specific basis. The Department should require the Company to provide a rate class specific reconciliation of transition charge revenues for the years beginning with 2002 in its next transition charge filing.

## V. CONCLUSION

The Department should adopt the recommendations in this brief in the best interests of ratepayers.

Respectfully submitted,

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